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South China cold chain enters fast track, welcomes U.S. input

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Approved by:
Joani Dong, Director
U.S. Agricultural Trade Office Guangzhou

Prepared by:
Ken Chen

Report Highlights:
Given the global financial crisis and aftermath of the melamine food scandal, how is the South China cold chain industry holding up? What future trends impact U.S. perishable food exports to this dynamic region? What role should USDA/FAS play? ATO Guangzhou responds.

Includes PSD Changes: No
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Annual Report
Guangzhou ATO [CH3]
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On October 28-29, ATO Guangzhou director and staff attended the *Global Cold Chain Alliance (GCCA) Shanghai Summit*, along with a delegation of 18 participants from eight Guangdong cold chain related companies, led by the *Guangdong Cold Chain Committee.* Such a substantial number is testament to the Committee's active involvement and membership interest in learning about latest trends and technologies to improve operational efficiency.

This event successfully served as a platform for communication, networking, education and showcasing technology between GCCA members and Chinese counterparts. ATO Shanghai is developing a separate report to provide details on the summit.

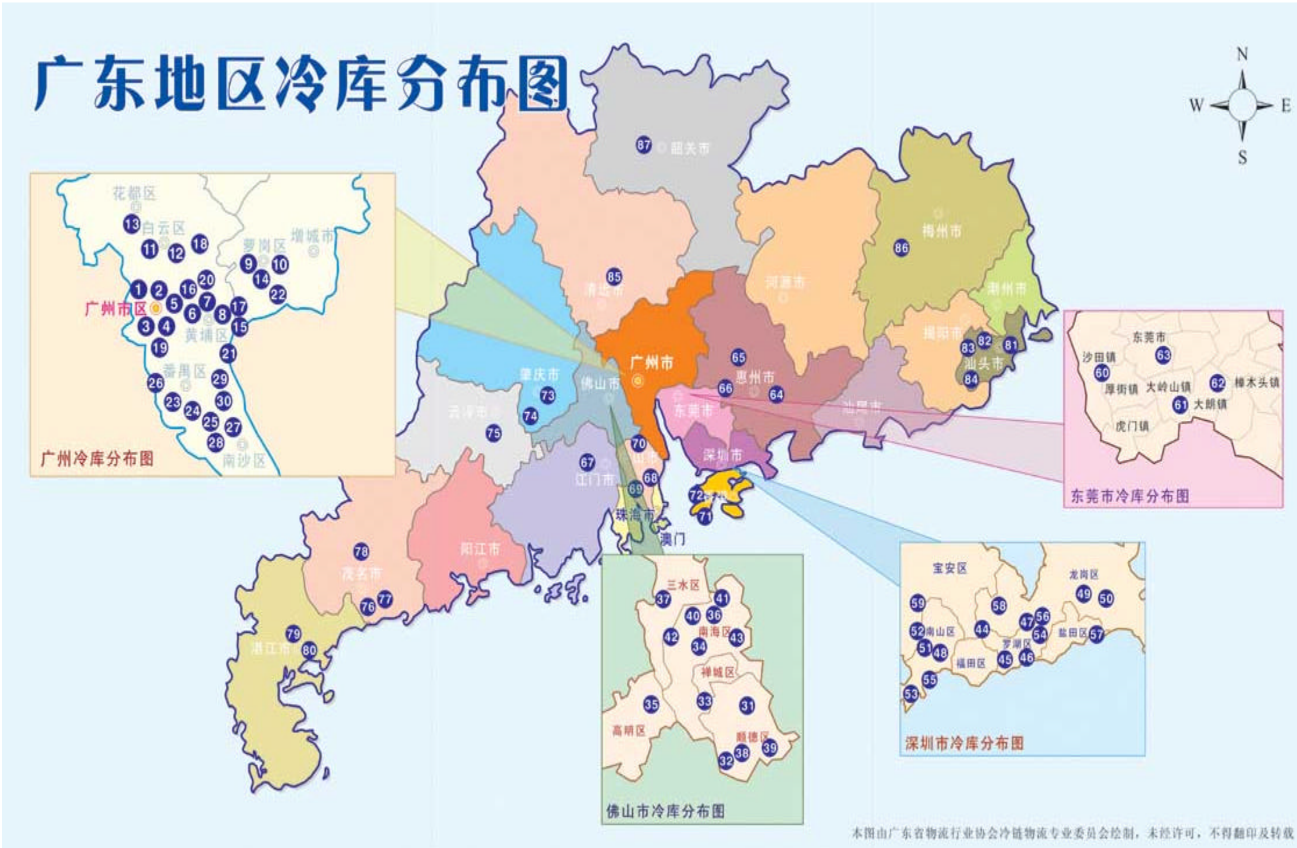
In this report Post presents overall cold chain developments and future trends in China, widely discussed and commonly agreed upon among South China Summit attendees. It further describes this pivotal region's latest developments and provides comment.

1. China's cold chain is in its infancy and is positioned to regenerate in a big way

In China, most perishable foods (80-90 percent), such as meat, fruits, vegetables, dairy and soybean products are shipped by non-refrigerated trucks. Because of the lack of effective cold supply chain systems, China annually suffers 25-30 percent food spoilage loss, valued US$65 billion, which could otherwise feed 200 million people.

<u>In South China</u>
According to the *GD Cold Chain Committee*'s recent survey, Guangdong has 87 large (defined as having 3,000 ton capacity or more) refrigerated warehouses with a total of more than 500,000 ton storage capacity, some which range from recently built to 30 years old. They congregate in three main areas: Guangzhou urban area, 120,000 tons; Guangzhou Panyu district, 100,000; and Shenzhen, 150,000.

Large Refrigerated Warehouses in Guangdong Province



(Source: GD Cold Chain Committee, www.cold-chain.org.cn)

To ensure product quality, several local dairy processors in Guangzhou, such as *Yacult*, *Bright Dairy* and *Xiangmanlou*, have established their own refrigerated trucking fleets of 20-30 trucks (mostly with 1.5 ton capacity).

2. China lacks standards covering all cold chain links; food safety is a key driver; large western fast food; and retail chains take the lead.

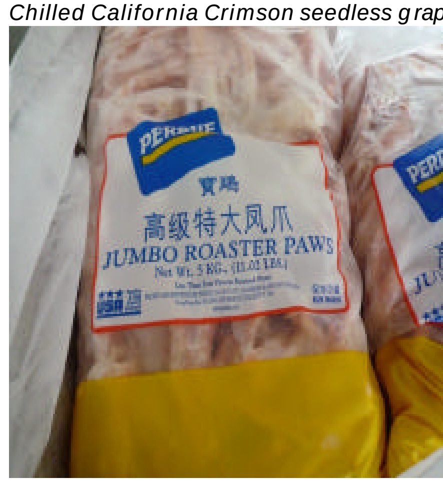
After numerous food scares in recent years, particularly the melamine milk scandal disclosed in September, food safety has become a priority concern for food shoppers. Large western fast food chains, such as *McDonald's* and *KFC*, and international retail chains, such as *Wal-Mart* and *Metro*, have become top destinations as these chains have their own high standard food safety assurance systems. The Chinese government plans to issue and implement a food safety law to strengthen regulatory and law enforcement for food production, processing, distribution and retailing. Standards will be developed for transportation, storage and processing of perishable food, but implementation will be the challenge. So will availability of credit and ethical issues.

In South China

McDonald and its contractor *Havi Logistics* as well as *Yum* (which own *KFC* and *Pizza Hut*) operate the most advanced refrigerated supply chain in South China.

Guangdong Province has the highest GDP at US$453 billion (RMB3,108 billion) of any single province in China, with retail sales valued at over US$154.7 billion (RMB 1,059.8 billion) in 2007, up 28.9 percent on 2006 figures. In other words, consumers can afford to buy quality food that includes the added cost of cold chain. Cold chain's rapid development because of increased living standards and demands from hosting huge events means that China needs modern cold chain technology to facilitate and support.

Chilled California Crimson seedless grapes



Frozen U.S. chicken paws
(Source: ATO Guangzhou)

Key retailers in South China are *Wal-Mart* (38), up by nine from the previous year; *Carrefour* (25), up by three; *Jusco* (13), up by two; *Metro* (7) up by two and *Tesco* (5), up by two. There are two *Sam's Clubs* in South China out of three in China. A new one will open in Guangzhou soon. All carry imported food, among which U.S. perishable food items, including Alaska seafood, poultry, *Sunkist* oranges, Washington apples, California table grapes and Northwest cherries are best sellers. There are also a wealth of domestic retailers that have limited space which don't allow for much cold storage capacity. Most of the middle class shop at supermarkets, but the question is frequency. Shoppers are constrained by how much they can carry for the many who don't own cars . . yet. Growth in retailers is anticipated in second and third tier cities. Much depends on growing acceptance of frozen and chilled food over preference for fresh.

In addition, consistent development of port facilities and potential cold chain improvement also help facilitate retail trade. In the meantime, retailers, such as *Wal-Mart* and *Metro*, have started to establish their own centralized and systematic logistic management including cold supply chains.

3. Importation is another key driver

South China, particularly Guangdong, is China's largest importer, consumer and distributor of U.S. perishable food, mostly poultry and fresh fruits. For instance, the *Jiangnan Fruit & Vegetable Wholesale Market* in Guangzhou trades 60-70 percent of all China's imported fruits, among which 50 percent are consumed in Guangdong, and the rest is distributed throughout China. As for poultry, over 60 percent of U.S. frozen poultry products are imported through Guangdong ports, such as Shenzhen and Guangzhou. China's largest frozen meat wholesale market is also in Guangzhou, requiring as much as 100,000 tons of refrigerated capacity to support it. Trading volume is poised to grow. As a result, more cold warehouses have been blueprinted to build, likely an increase of 60,000 tons capacity by 2010.

Recently *China's State Council* approved two bonded ports in Guangdong: Nansha in southern Guangzhou and Qianhai Bay in western Shenzhen. Bonded ports are friendly to processing trade and logistic distribution. For instance, imported U.S. frozen meat can be stored, processed and re-packed at bonded ports without paying tariffs and value-added tax until it enters the China market or re-exported to other countries or areas. There are only ten ports of this kind in China, and five are in South China.

South China Bonded Ports

	Bonded Port	City	Province	Area (square mile)	Approval Date	Estimated operational date
1.	Yang Pu Port	Yangpu	Hainan	3.55	Oct 2007	By end of 2008
2.	Hai Cang	Xiamen	Fujian	3.65	Jun 2008	By end of 2009
3.	Qing Zhou Port	Qingzhou	Guangxi	3.86	May 2008	By end of 2009
4.	Qian Hai Bay	Shenzhen	Guangdong	1.43	Oct 2008	Unknown
5.	Nan Shan	Guangzhou	Guangdong	2.73	Nov2008	Unknown

(Source: Xinhua News, www.news.cn)

The other five bonded ports are Yangshan of Shanghai, Dongjiang of Tianjin, Dayao Bay of Dalian, Meishan of Ningbo and Qiang Bay of Qingdao.

4. Investments are pouring in with governmental endorsement

Despite the recent global financial crisis, there is still a surge of investment in building new refrigerated warehouses or distribution centers in South China. Funding sources are varied: Chinese state owned or individual logistic companies, food processing plants, retailers, real estate developers, ocean shippers and foreign cold chain operators. The largest U.S. cold chain company, *Americold,* has been looking for joint venture partners in China after its management met with Cochran fellows this past April during the GCCA annual meeting in the States.

The most ambitious project will cost US$265 million (RMB1.8 billon) to build an agricultural wholesale market and ambient/refrigerated warehouses in Shenzhen. The local government has listed it as the key infrastructure construction and promised to cover interest of related bank loans.

Last week, the Chinese central government announced a US$588 billion (RMB4 trillion) stimulus package to boost its economy. As part of infrastructure development and the positive role it plays in boosting domestic consumption, the cold chain industry will have a bite of this huge carrot.

5. The key will be return on investment and public-private partnership

Without regulations with proper enforcement, the driving force for implementing best practice for third party refrigerated warehouse operators is profit. It is critical to develop an understanding at the refrigerated warehouse management level to demonstrate that implementing best practice yields favorable return on investment, specifically involving refrigeration systems, product handling systems (IT and racking systems) as well as facility design.

In addition, when industry and government see cold chain development as good for the bottom line, meaning that food safety; food quality; overall efficiency and productivity in the agricultural sector is something that everyone wants and is willing to pay for in terms of equipment costs, then everyone wins. The key issue is competition versus cooperation.

Fierce competition can mean cutting corners or the cost of doing things the right way. Industry can't be expected to enforce itself. Therefore, public-private cooperation is paramount. This calls for the government to step in to help set up and enforce a regulatory framework while working with industry. China already has the economic need, political will and capital for a modern cold chain industry. But its need to develop cold chain faster than any other developing country in line with its ultra rapid growth and understandable lack of experience means it needs a hand. At the root, the Chinese government has to be convinced of the need for such a framework.